ACCOUNTING ILLUSTRATION

ACCOUNTING FOR INVENTORIES WHEN USING LATEST ACQUISITION COST PRACTICES

A. GENERAL

1. The Defense Logistics Agency records inventory at its latest acquisition cost. That value may change with each acquisition made during a fiscal year. The difference between the actual cost of items held in inventory and the value of those same items if they were acquired at the latest acquisition cost is an unrealized gain which will not become realized until that item is sold or otherwise leaves the supply management stocking point. Holding gain and loss accounts have been established to accumulate the value of holding gains and losses during the fiscal year. When inventory is classified as potential excess, sold or otherwise leaves the stocking point, the previously unrealized holding gain or loss is realized and recorded in account 1529.1A, "Realization of Holding Gains/Losses." The holding gains and accounts are:

*	1529.1A	Realization of Holding Gains/Losses
*	1529.1B	Purchases at Standard Price
*	1529.1C	Purchases at Cost
*	1529.1D	Materiel Returns at Standard Price
*	1529.1E	Materiel Returns - Credit Given
*	1529.1F	Materiel Returns Without Credit Given
*	1529.1G	Standard Price Changes-Gain
*	1529.1H	Accounting Adjustments-Gain
*	1529.1J	Assembly/Disassembly-Gain
*	1529.1K	Physical Inventory Adjustments-Gain
*	1529.1L	Incoming Shipments-Gain
*	1529.1M	Completed Inventory Repairs
*	1529.1N	Receipts of Materiel Without Charge
*	1529.1P	Other-Gain
*	1529.1Q	Latest Acquisition Cost Adjustment
*	1529.1R	Standard Price Changes-Loss
*	1529.1S	Accounting Adjustments-Loss
*	1529.1T	Assembly/Disassembly-Loss
*	1529.1U	Physical Inventory Adjustments-Loss
*	1529.1V	Incoming Shipments-Loss
*	1529.1W	Shrinkage and Other Adjustments-Loss
*	1529.1X	Actual Repair Costs
*	1529.1Y	Issues Without Reimbursement
*	1529.1Z	Other-Loss

NOTE: Every event that results in a change in the quantity of inventory, the value of existing inventory, or both should be reflected in one of the holding gain or loss accounts specified above. If one of the above accounts is not descriptive of a recurring and significant inventory event, then an additional holding gain/loss account(s) may be established for that purpose.

2. For financial statement presentation, inventory is shown at its latest acquisition cost. The cost of inventory items sold is shown, in accordance with Statement of Federal Financial Accounting Standards No. 3,

"Accounting for Inventory and Related Property," at an approximation of its historical (actual) cost.

3. The following simplified illustration provides an explanation, in accounting terms, of the accounting necessary to properly record the DBOF supply management inventory for those supply management business areas which maintain inventory values at the latest invoice price. The illustration demonstrates the affect on unrealized holding gains due to purchases, latest acquisition cost adjustments, inventory returns, and other transactions. The illustration also demonstrates computation necessary to properly adjust cost of goods sold to the actual cost of the items sold.

B. MONTH ONE

1. ESTABLISH INITIAL INVENTORY ALLOWANCE AMOUNT. As of October 1, 1994, general ledger account 1529.1, "Allowance for Holding Gain/Loss - Inventory Held for Sale," general ledger account 1529.2, "Allowance for Holding Gain/Loss - Inventory Held in Reserve for Future Sale," and general ledger account 1529.3, "Allowance for Repairs," should be established to identify cost recovery factors (i.e., surcharges), prior year inflation, repair costs, and write-down of potential excess at the same amount of the last adjustment contained in the FY 1994 Chief Financial Officer Act financial report submission. This is a one-time step to initially establish the allowance account at the same value as reported on the prior year CFO submission. For following years, the inventory allowance account will be continued at its then current amount. For illustration purposes, assume the initial allowance amount for "Inventory Held For Sale" is $2,000. The following tables are included to assist in the understanding of the inventory accounting process. The table to illustrate the beginning inventory position for "Inventory Held for Sale," is:

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	$29,500	$2,000	$27,500

2. PURCHASE OF INVENTORY ITEMS

Dr 1521 Inventory Held for Sale	$3,000	
Cr 2110 Applicable Accounts Payable Series		$3,000

Entry to record purchase of 10 inventory items at $300 per item. (If the purchase quantity and price is a representative purchase, then that price shall be the "Latest Acquisition Cost.")

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	$29,500	$2,000	$27,500
B.2.	10	$ 3,000	$ -0-	$ 3,000

3. <u>ADJUSTMENT OF INVENTORY TO LATEST ACQUISITION COST</u>.

Dr 1521 Inventory Held for Sale $ 500
Cr 1529.1Q Latest Acquisition Cost Adjustment $ 500 1/

Entry to adjust value of other inventory items in stock to the latest acquisition cost when the recorded value of those items is LESS than the latest acquisition cost. [Assume that 100 items are in inventory and the previous latest acquisition cost was $295 per item. Those items require revaluation to the current latest acquisition cost of $300. The revaluation will then require recognition of a $500 unrealized gain -- 100 items @ $5 adjustment per item = $500.]

1/ Gains or losses associated with the valuation of inventory, although recognized, are not realized. Realization of the gain or loss occurs only when an item of inventory is sold or otherwise disposed.

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	$29,500	$2,000	$27,500
B.2.	10	$ 3,000	$ -0-	$ 3,000
B.3.	N/A	$ 500	$ 500	N/A

4. CUSTOMER RETURNS OF MATERIAL WITHOUT CREDIT

Dr 1521 Inventory Held for Sale $900
Cr 1529.1F Materiel Returns Without Credit Given $900

Entry to record a return of 3 inventory items from customers for which a credit is not granted. The Latest Acquisition Cost of each item is $300 (3 x $300 = $900).

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	$29,500	$2,000	$27,500
B.2.	10	$ 3,000	$ -0-	$ 3,000
B.3.	N/A	$ 500	$ 500	N/A
B.4.	3	$ 900	$ 900	$-0-

5. CUSTOMER RETURNS OF MATERIAL WITH CREDIT

Dr 1521 Inventory Held for Sale $900 1/
Cr 1529.1D Materiel Returns at Standard $900 1/

Dr 1529.1E Materiel Returns - Credit Given $600 2/
Cr 1311 Accounts Receivable-Government-Current $600 2/

Entry to record a return of 3 inventory items from customers for which a credit of $200 per item is granted.
1/ The LAC of each item is $300 (3 x $300 = $900).
2/ $200 credit per item x 3 items = $600

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	$29,500	$2,000	$27,500
B.2.	10	$ 3,000	$ -0-	$ 3,000
B.3.	N/A	$ 500	$ 500	N/A
B.4.	3	$ 900	$ 900	$-0-
B.5.	3	$ 900	$ 300	$600

6. SALE OF INVENTORY

Dr 1311	Accounts Receivable-Government - Current	$19,250 1/
Cr 5101	Revenue from Goods Sold - DBOF	$19,250 1/
Dr 6500	Cost of Goods Sold	$16,500 2/
Cr 1521	Inventory Held for Sale	$16,500 2/

Entry to record sale of inventory and the associated cost of the goods sold.

1/ 55 items are sold for $350 per item for a total of $19,250.

2/ The latest acquisition cost is $300 per item for a total inventory reduction of $16,500 (55 items x $300 = $16,500). [See month-end adjusting entry for adjustment of the "Cost of Goods Sold" account.]

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	$29,500	$2,000	$27,500
B.2.	10	$ 3,000	$ -0-	$ 3,000
B.3.	N/A	$ 500	$ 500	N/A
B.4.	3	$ 900	$ 900	$-0-
B.5.	3	$ 900	$ 300	$ 600
B.6.	(55)	($16,500)		

7. REVALUATION OF EXCESS INVENTORY

Dr 1524	Inventory - Excess, Obsolete, and Beyond Repair	$ 70 1/
Dr 1529.1A	Realization of Holding Gains/Losses	$ 319 2/
Dr 7291.2	Excess/Obsolescence/Spoilage Loss	$2,611 3/
Cr 1521	Inventory Held for Sale	$3,000 1/

Entry to reclassify inventory items when those items are stratified as potential excess. [NOTE: In this illustration, these potential excess items are transferred to reutilization and marketing in the following month. See "Month 2," transaction 3 on page 101.]

1/ 10 items with a carrying value of $300 per item = $3,000 were determined potentially excess. Items declared potentially excess should be valued at net realizable value (currently, approximately 2 percent of standard [sales] price -- in this

illustration, the sales price is $350 per item x 10 items = $3500 x 2 percent = $70).

2/ When items move between inventory categories, the allowance account in the respective inventory categories are decreased/ increased respectively. In this case items are moving from the "Inventory Held for Sale" category to the "Inventory Held for Future Sale" category. The amount of the allowance is determined by adding the net value of the allowance account from which the inventory is to be transferred and then dividing that net total by the number of items in inventory. In this case, the net total of the allowance account is $3,700 [$2,000 beginning balance + $500 price change gain + $1,200 gain on customer returns = $3,700]. $3,700 + 116 items = $31.90 per item x 10 items = $319. An alternative computation is to use the percentage amount determined in the month-end adjustment of cost of goods. That percentage amount, in this illustration is 89.37 percent. 89.37 percent x $3,000 = $2,681 - $3,000 = $319.

3/ The $3000 carrying value of the inventory less the $70 salvage value and less the $319 allowance equals the $2,611 loss.

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	$29,500	$2,000	$27,500
B.2.	10	$ 3,000	$ -0-	$ 3,000
B.3.	N/A	$ 500	$ 500	N/A
B.4.	3	$ 900	$ 900	$-0-
B.5.	3	$ 900	$ 300	$600
B.6.	(55)	($16,500)		
B.7.	(10)	($ 3,000)	($ 319)	N/A

Inventory - Excess, Obsolete, and Beyond Repair				
Transaction	Quantity	2% of Standard Price	Allowance Amount	Amount Paid (Cost)
B.7.	10	$ 70	N/A	N/A

7. MONTH-END ADJUSTMENT OF COST OF GOODS SOLD

Dr 1529.1A	Realization of Holding Gains/Losses	$1,754 1/
Cr 6500	Cost of Goods Sold	$1,754 1/

Entry to record sale of inventory and the associated cost of the goods sold. The sales price will generally be more than the latest acquisition cost due to the inclusion of cost recovery elements in the selling price.

1/

INVENTORY HELD FOR SALE

	Cost	Unrealized Gain (Loss)	LAC
Beginning Inventory	$27,500	$2,000	$29,500
Price Change		$ 500	$ 500
Purchases	$ 3,600	$1,200	$ 4,800
TOTAL	$31,100	$3,700	$34,800
Excess Inventory Transfer	($ 2,681)	($ 319)*	($ 3,000)
Cost of Goods Sold	($14,746)	($1,754)*	($16,500)
Ending Inventory	$13,673	$1,627	$15,300

* Cost of Goods Sold Computation

$3,700 Unrealized Gain + $34,800 LAC = .1063
.1063 x $3,000 Excess Inventory at LAC = $319 realized gain
.1063 x $16,500 Cost of Goods Sold at LAC = $1,754 realized gain
$16,500 Cost of Goods Sold at LAC - $1,754 realized gain = $14,746

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	$29,500	$2,000	$27,500
B.1.	10	$ 3,000	$ -0-	$ 3,000
B.2.	N/A	$ 500	$ 500	N/A
B.3.	3	$ 900	$ 900	$ -0-
B.4.	3	$ 900	$ 300	$ 600
B.5.	(10)	($ 3,000)	($ 319)	N/A
B.6.	(55)	($16,500)		
B.7.	N/A		($1,754)	($17,427)
Total	51	$15,300	$1,627	$13,673

FINANCIAL STATEMENT PRESENTATION
MONTH ONE

Cost of Material Sold from Inventory	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Total
(1) Beginning Inventory	$29,500			$29,500
(a) Less: Beginning Allowance	$ 2,000			$ 2,000
(b) Plus: Purchases at Cost	$ 3,000			$ 3,000
(c) Plus: Customer Returns - Credit Given	$ 600			$ 600
(d) Plus: DLR Exchange Credits	N/A			
(e) Less: Inventory Losses Realized	$2,611			$2,611
Internal Movements between Inventory Classifications	($ 70)		$ 70	$ -0-
(2) Less: Ending Inventory	$15,300		$ 70	$15,370
(a) Plus: Ending Allowance	$ 1,627			$ 1,627
Cost of Goods Sold	$14,746			$14,746

C. MONTH TWO

1. PURCHASE OF INVENTORY ITEMS

Dr 1521 Inventory Held for Sale $7,750
Cr 2110 Applicable Accounts Payable Series $7,750

Entry to record purchase of 25 inventory items at $310 per item. (If the purchase quantity and price is a representative purchase, then that price shall be the "Latest Acquisition Cost.")

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	$15,300	$1,627	$13,673
C.1.	25	$7,750	N/A	$7,750

2. ADJUSTMENT OF INVENTORY TO LATEST ACQUISITION COST.

Dr 1521 Inventory Held for Sale $ 510
Cr 1529.1Q Latest Acquisition Cost Adjustment $ 510 1/

Entry to adjust value of the 51 inventory items in stock to the latest acquisition cost. [The latest acquisition cost of the 51 items in stock was $300 per item. Those items require revaluation to the current latest acquisition cost of $310. The revaluation will then require recognition of a $510 unrealized gain -- 51 items @ $10 adjustment per item = $510.]

1/ Note that under the latest acquisition cost method, gains or losses associated with the valuation of inventory, although recognized, are not realized. Realization of the holding gain or loss occurs only when an item of inventory is sold.

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	$15,300	$1,627	$13,673
C.1.	25	$7,750	N/A	$7,750
C.2.		$ 510	$ 510	N/A

3. TRANSFER OF EXCESS, OBSOLETE, OR BEYOND REPAIR INVENTORY

a. Excess, Obsolete, and Beyond Repair Inventory Transferred by Stock Point to Defense Reutilization and Marketing Service (DRMS)

Dr 7291.2	Excess/Obsolescence/Spoilage Loss	$ 70	
Cr 1524	Inventory - Excess, Obsolete, and Beyond Repair		$ 70

Entry recorded by stock point to transfer excess, obsolete, or beyond repair items to the DRMS.

Inventory - Excess, Obsolete, and Beyond Repair				
Transaction	Quantity	Salvage Value	Allowance Amount	Amount Paid (Cost)
B.6.	10	$ 70	N/A	N/A
C.3.a.	(10)	($ 70)	N/A	N/A
Total	-0-	-0-	N/A	N/A

b. Excess, Obsolete, and Beyond Repair Inventory Received by Defense Reutilization and Marketing Service (DRMS)

Dr 1765	Property Awaiting Disposal	$ 70	
Cr 7193	Other Miscellaneous Gains		$ 70

Entry recorded by DRMS for the transferred value of items declared excess, obsolete, or beyond repair.

4. PHYSICAL INVENTORY ADJUSTMENTS

Dr 1521	Inventory Held for Sale	$1,860 1/	
Cr 1529.1K	Physical Inventory Adjustments-Gain		$1,860 1/

Entry to record gains or losses due to differences between physical inventory counts and inventory records in inventory quantities. The gain or loss shall be recorded at the current carrying value of the items (an increase to inventory for gains and a decrease to inventory for losses).

1/ Physical inventory shows that 6 more items exist than records show. (6 items x $310 LAC = $1,860 gain)

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	$15,300	$1,627	$13,673
C.1.	25	$7,750	N/A	$7,750
C.2.		$ 510	$ 510	N/A
C.4.	6	$1,860	$1,860	$-0-

5. <u>SALE OF INVENTORY</u>

Dr 1311 Accounts Receivable-Government - Current $22,750 1/
Cr 5101 Revenue from Goods Sold - DBOF $22,750 1/

Dr 6500 Cost of Goods Sold $20,150 2/
Cr 1521 Inventory Held for Sale $20,150 2/

Entry to record sale of inventory and the associated cost of the goods sold. The sales price will generally be more than the latest acquisition cost due to the inclusion of cost recovery elements in the selling price.

1/ 65 items are sold for $350 per item for a total of $22,750.

2/ The latest acquisition cost is $310 per item for a total inventory reduction of $20,150 (65 items x $310 = $20,150). [See month-end adjusting entry for adjustment of the "Cost of Goods Sold" account.]

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	$15,300	$1,627	$13,673
C.1.	25	$ 7,750	N/A	$7,750
C.2.		$ 510	$ 510	N/A
C.4.	6	$ 1,860	$1,860	$-0-
C.5.	(65)	($20,150)		

6. MONTH-END ADJUSTMENT OF COST OF GOODS SOLD

Dr 1529.1A Realization of Holding Gains/Losses $ 2,721 1/
Cr 6500 Cost of Goods Sold $ 2,721 1/

In the preceding entry (transaction C.5.), account 6500, "Cost of Goods Sold," was debited for the latest acquisition cost of inventory sold. The purpose of this entry is to adjust account 6500 to the historical cost (vice latest acquisition cost) of inventory sold.

1/

INVENTORY HELD FOR SALE

	Cost	Unrealized Gain	LAC
Beginning Inventory	$13,673	$1,627	$15,300
Purchases	$ 7,750		$ 7,750
Price Change		$ 510	$ 510
Physical Inventory Gain		$1,860	$ 1,860
TOTAL	$21,423	$3,997	$25,420
Cost of Goods Sold	($17,429)	($2,721)*	($20,150)
Ending Inventory	$ 3,994	$1,276	$ 5,270

* Cost of Goods Sold Computation

$3,977 Unrealized Gain + $29,450 LAC = .1350
.1350 x $20,150 Goods Sold at LAC = $2,721 realized gain
$20,150 Goods Sold at LAC - $2,721 realized gain = $17,429

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	$15,300	$1,627	$13,673
C.1.	25	$ 7,750	N/A	$ 7,750
C.2.		$ 510	$ 510	N/A
C.4.	6	$ 1,860	$1,860	$ -0-
C.5.	(65)	($20,150)		
C.6.			($ 2,721)	($17,429)
Total	17	$ 5,270	$ 1,276	$ 3,994

FINANCIAL STATEMENT PRESENTATION
MONTH TWO

Cost of Material Sold from Inventory	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Total
(1) Beginning Inventory	$15,300		$ 70	$15,370
(a) Less: Beginning Allowance	$ 1,627			$ 1,627
(b) Plus: Purchases at Cost	$ 7,750			$ 7,750
(c) Plus: Customer Returns - Credit Given				
(d) Plus: DLR Exchange Credits	N/A			
(e) Less: Inventory Losses Realized			$ 70	$ 70
Internal Movements of Inventory				
(2) Less: Ending Inventory	$ 5,270			$ 5,270
(a) Plus: Ending Allowance	$ 1,276			$ 1,276
Cost of Goods Sold	$17,429		$-0-	$17,429